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ABSTRACT

This report presents recommendations from the Office of Inspector General for amendments to the 1998 Reauthorization of the Higher Education Act that are intended to improve integrity of student financial assistance programs and to save taxpayer dollars. Seventeen proposals divided into four areas--institutional eligibility and enforcement; student eligibility; loan programs; and law enforcement are presented. Each proposal delineates the Inspector General's position, the current law, recommended changes, and the rationale for the proposed change. Proposals include: legislating performance standards for vocational schools, eliminating Pell eligibility for high-default schools and eliminating Pell advance funding; restricting distance learning to academic degree programs; requiring schools to post surety when appealing loss of eligibility due to high default rates; legislating separate statutory requirements for vocational trade schools; eliminating the 25-year-old requirement for Pell Advance Funding requiring verification of applicant income data with the Internal Revenue Service; limiting exercise of professional judgment by financial aid administrators; requiring annual reconciliation of student loan data; changing the definition of loans in repayment; standardizing accounting and reporting for guaranty agency funds; requiring certification of vocational trade school refund liabilities; requiring discharge of loans to student victims of fraud; prohibiting consolidation of defaulted loans; requiring determination of ability-to-repay in Parent Loans for Undergraduate Student program and joint parent/student liability; change record retention period; and extend statute of limitations for financial institution fraud. (CH)

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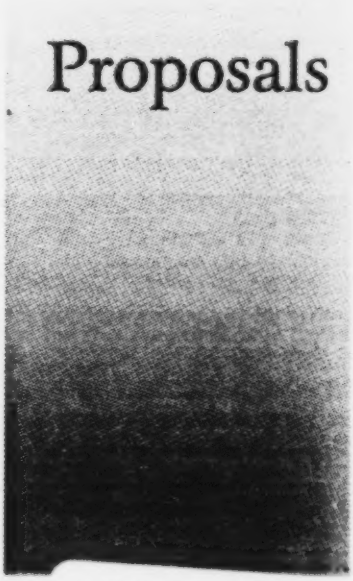
U.S. Department of Education
Office of Inspector General

1998 Reauthorization of the Higher Education Act

OIG Proposals



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July 1997

S15-60006

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

JUL - 3 1997

Dear Member of Congress:

The purpose of this letter is to transmit the Office of Inspector General's recommendations for amendments to the Higher Education Act (HEA). This is in accordance with our mission to promote the efficient and effective use of taxpayer dollars in support of education and to provide independent and objective assistance to the Congress to assure continuous improvement in program delivery, effectiveness, and integrity.

As we have reported in previous testimonies, there are persistent problems in the programs covered by the HEA that require statutory change. Our suggestions for amendments to the HEA are based on audits and investigations performed in compliance with our mission and are intended to address weaknesses and problems that we have identified. We are providing you with seventeen proposals that have been divided into four areas: 1) Institutional eligibility and enforcement; 2) Student eligibility; 3) Loan programs; and 4) Law enforcement.

We appreciate the opportunity to share our proposals with you. We share your dedication to improving the programs and your concern for the students, the primary beneficiaries of the HEA. Should you have any questions or comments regarding our recommendations, we would welcome the opportunity to discuss them.

Sincerely,

Thomas R. Bloom

600 INDEPENDENCE AVE., S.W. WASHINGTON, D.C. 20202-1510

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

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EXECUTIVE SUMMARY

The 105th Congress has an opportunity to improve substantially the integrity of the Student Financial Assistance (SFA) programs and save taxpayers and students significant amounts of money through the 1998 reauthorization of the Higher Education Act (HEA). During the 1992 HEA reauthorization, Congress legislated a number of helpful reforms, including the 50-percent limitation on ability-to-benefit students, the requirement for trade schools to certify that no more than 85 percent of their funding is derived from HEA Title IV programs, statutory financial responsibility standards, and controls on institutional practices such as 30-day delayed disbursement, pro rata refunds, and multiple loan disbursements. The Office of Inspector General (OIG) believes that Congress should build on those reforms and continue to improve the integrity of the SFA programs.

To assist Congress in this important task, the OIG has prepared the following recommendations for amendments to the HEA. These recommendations are based on OIG audits, investigations and other data about fraud, waste and abuse in the SFA programs.

The OIG recommendations are organized into four major areas:

- Institutional eligibility and enforcement
- Student eligibility
- Loan programs
- Law enforcement

Each proposal sets forth our position, the current law, the recommended change to the law, and our rationale for the proposed change, as summarized below.

Institutional Eligibility and Enforcement

The mechanisms for ensuring that only high quality and well-administered schools participate in the SFA programs continue to need improvement in order to ensure the integrity of the programs. We recommend that Congress --

- legislate performance standards for vocational schools,
- eliminate Pell eligibility for high-default schools,
- restrict distance learning to academic degree programs,
- require schools to post a surety when appealing loss of eligibility due to high-default rates,
- legislate separate statutory requirements for vocational trade schools, and
- eliminate the 25-year-old requirement for Pell advance funding.

Student Eligibility

In order to ensure that students are receiving appropriate amounts of federal aid, we recommend that Congress --

- require verification of applicants' income data with IRS, and
- limit professional judgment by financial aid administrators.

Loan Programs

Effective management of the loan programs is dependent upon accurate and timely data. Therefore, we recommend that Congress --

- require annual reconciliation of NSLDS data,
- change the definition of loans in repayment, and
- standardize accounting and reporting for guaranty agency reserve funds.

In order to ensure that students are receiving their refunds, we recommend that Congress --

- require certification of refund liabilities by vocational trade schools, and
- require discharge of loans to the extent of unpaid refunds for student victims.

In addition, to protect the integrity and reduce the cost of the Consolidation and PLUS loan programs, we recommend that Congress --

- prohibit the consolidation of defaulted loans, and
- require the determination of the ability to repay PLUS loans and require joint parent/student liability.

Law Enforcement

Due to the length of time it takes to prepare complex court cases against institutions that defraud the SFA programs, we recommend that Congress --

- require that SFA records be retained for five years and that certain original records be retained, and
- apply the extended statute of limitation for financial institution fraud to the FDLP.

CONTACT PERSON: Ellen Bass, Counsel to the Inspector General and Legislative Liaison

Institutional Eligibility and Enforcement

Legislate Performance Standards for Vocational Schools

To ensure the quality of vocational training funded by the Student Financial Assistance (SFA) programs, schools that provide vocational training programs (i.e., proprietary institutions of higher education and postsecondary vocational institutions) should be required to meet statutory performance standards for student outcomes as an eligibility criterion for participation in the SFA programs, in particular specific criteria for completion and job placement rates. Currently, most vocational schools can continue to participate in SFA programs even though they provide inadequate training for jobs that may not be available, and, as a result, have extremely low completion and job placement rates. This results in substantial harm to both the students and the taxpayers when millions of dollars of SFA funds are spent annually on unsuccessful training.

Current Law Provides

Several provisions of the current Higher Education Act (HEA) reflect the legislative intent that vocational training financed with SFA funds is to prepare students for gainful employment. Section 481 of the HEA defines a "proprietary institution of higher education" and a "postsecondary vocational institution" as

> **"... a school (1) which provides an eligible program of training to prepare students for gainful employment in a recognized occupation..."**

Substantially the same language appears in the definition of an "eligible program." Section 481 (e) (1) (A) of the HEA defines a short-term program as

> **"600 clock hours of instruction, 16 semester hours, or 24 quarter hours, offered during a minimum of 15 weeks, in the case of a program that - (i) provides a program of training to prepare students for gainful employment in a recognized profession; and (ii) admits students who have not completed the equivalent of an associate degree..."**

As a result of the 1992 amendments to the HEA, short-term programs of at least 300 clock hours, but less than 600 clock hours,

are required to have performance standards for completion and job placement as an eligibility criterion. Section 481 (2) (A) of the HEA provides the requirement that such a program

> **"(i) has a verified completion rate of at least 70 percent, as determined in accordance with the regulations of the Secretary;**
>
> **(ii) has a verified placement rate of at least 70 percent, as determined in accordance with the regulations of the Secretary;..."**

For other eligible institutions and programs, in the HEA amendments of 1992 Congress deferred to the accrediting agencies to establish performance standards for their member schools as a condition for accreditation status. Section 496 (a) (5) requires that accrediting agencies recognized for purposes of the SFA programs assess, among other things, an institution's

> **"success with respect to student achievement in relation to its mission, including, as appropriate, consideration of course completion, State licensing examination, and job placement rates."**

Suggested Legislative Change

The definitions of "proprietary institution of higher education" and "postsecondary vocational institutions" in section 481 of the HEA should be amended to add a requirement for measurable performance standards at least in the areas of completion and job placement rates. The definition could include, at a minimum, substantially the same language as that now in section 481 (c) (1) (A) for short-term programs, i.e.,

> **...on an annual basis has a verified completion rate of at least 70 percent and has a verified placement rate of at least 70 percent.**

Why Current Law Should Be Changed

Although "proprietary institutions of higher education" and "postsecondary vocational institutions" are supposed to train graduates for gainful employment there are generally no statutory performance standards to ensure they do so. Except for the short-term vocational training programs offering programs between 300 and 600 clock hours, there is no statutory performance standard that these schools have to meet to become eligible and to maintain eligibility for the SFA programs. These institutions that measure their vocational programs in credit hours or provide programs of at least 600 clock hours avoid the statutory performance standards.

The Office of Inspector General (OIG) first reported in March 1987 that many students who received SFA funds were being trained for occupations for which there were limited employment opportunities. In March 1993, we again reported that for students enrolled in vocational training programs, the current system affords little assurance that the training provided will lead to gainful employment. Our study focused on supply and demand data from the cosmetology profession. We concluded that SFA programs provided millions of dollars for cosmetology training for students that never completed their programs, and the supply of licensed cosmetologists being trained annually far exceeded the demand for cosmetologists. Without jobs, students do not pay taxes and default on loans more frequently. We recommended that the U.S. Department of Education (Department) seek legislative change to the SFA funding system to consider labor market needs and the success rate of schools in placing graduates for vocational training programs.

The HEA provided for the accrediting agencies to establish standards for their schools to measure the success of student outcomes. In May 1995, we reported on the progress of five accrediting agencies in developing and implementing standards for student outcomes. These agencies accredited schools that offer vocational training programs and we looked specifically at their standards for completion and job placement rates. We found that the accrediting agencies had made little progress in developing performance standards. The agencies were generally not using performance measures to evaluate the success of their member schools; and the agencies were reluctant to use performance data to assess the effectiveness of schools' job training programs because they did not view their role as government regulators. Several

agencies suggested that the Department define the outcome measures and establish standards for SFA-funded job training.

The Department took the position that the accrediting agencies should be allowed flexibility in developing their standards, and the standards do not necessarily have to be **numerical or absolute**. The standards could be goals that schools should work to, but may never achieve.

We unsuccessfully elevated the audit dispute to the Department's Audit Follow-up Official in May 1996. A follow-up OIG review of accrediting agencies during 1996 found that, while some accrediting agencies were developing performance standards, none of the agencies were enforcing compliance by their member schools.

Performance standards are needed to measure, in particular, the success of schools that admit Ability-To-Benefit (ATB) students. Congress and the Department have struggled for many years to regulate appropriately schools admitting ATB students, and there has been a great deal of fraud and abuse in the area of eligibility for ATB students. An OIG study indicated that proprietary vocational schools that require high school credentials for admission have a significantly lower default rate than those schools that admit students under ATB testing. In comparing schools requiring high school credentials for admission to those that admit under ATB testing, the average default rate rose from 16 percent to 28 percent. Default rates also increased from 28 percent to 38 percent as the percentage of ATB enrollments increased from 10 percent to 20 percent. Performance standards for completion and job placement rates should reduce defaults at schools that admit ATB students.

Legislating verifiable performance standards will also help to address abuses we have found through OIG investigations such as recruiting students who are likely never to attend class or withdraw from the program. For example, one OIG investigation of an institution revealed that it cost taxpayers approximately $485,000 in SFA program funds for each of eight state cosmetology licenses obtained by the few students who completed the program relative to the large number of students for whom the school received Pell Grants. In another investigation of a California institution, we discovered that only 186 out of 968 students graduated from a hotel/resort management travel program, costing approximately

$11,800 per graduate. Only two of the 186 students were confirmed as placed in jobs for which the institution purported to train them at a cost of $1.1 million in federal funds per job.

Other OIG investigations revealed that institutions received SFA funds for students who did not have the ability to benefit from the program. For example, an Ohio institution recruited vast numbers of students who were not capable of or motivated to get an education and therefore, could be counted on to drop out early in the program. These actions allowed the institution to receive federally insured student loan funds of over $101 million and Pell Grant funds of $42 million during a four-year period for students who essentially did not have the ability to benefit from the institution's program. In another case, an institution in California enrolled students who could not pass the entrance exam and allowed, in some cases, employees of the institution to complete the test for the prospective students.

Another problem with the current system relying on accrediting agencies is that the performance data provided by schools is unverified. Statutory standards will allow independent audits of schools' data. OIG investigations have recorded instances where institutions have falsified student enrollment and attendance documents to disguise low student completion and graduation rates. The Ohio institution discussed above concealed its 50 percent withdrawal rate by filing accrediting agency annual reports that contained false and fraudulent figures.

We believe that what you measure you get. Unless the Congress mandates completion and job placement rates for proprietary and postsecondary vocational schools, there will be no assurance of the quality of the vocational training programs funded through the SFA programs. A 70 percent completion rate and a 70 percent placement rate are modest standards; it means that only 49 percent or almost one out of two students who enroll is successful in obtaining gainful employment. This is not an unreasonable expectation for these schools to achieve.

References

1. OIG audit report *Improvements Needed in Delivery of Vocational Training*, ACN 04-30063, dated March 1987.

2. OIG Management Improvement Report No. 93-03, *Title IV Funding for Vocational Training Should Consider Labor Market Needs and Performance Standards*, dated March 12, 1993.

3. OIG audit report *Managing for Results, Review of Performance-Based Systems at Selected Accrediting Agencies*, ACN 06-30004, dated May 8, 1995.

4. OIG Memorandum on *Impact of Ability-To Benefit Provision on Student Loan Default and Graduation Rates*, dated December 5, 1996.

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Eliminate Pell Eligibility for High-Default Schools

The loss of a school's eligibility to participate in the Pell Grant program because of three consecutive years of high loan default rates should be made part of the general eligibility criteria incorporated into the HEA. Based upon our experience with these schools, we believe that the prohibition on participation in the Pell Grant program for high-default schools is a good anti-fraud, waste, and abuse measure and should be incorporated into the HEA so that it will have effect for more than one year at a time. Such action would reduce expenditures to the Pell Grant program by about $5 million annually.

Current Law Provides

Section 512 of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (P. L. 104-134) provides that a school ineligible to participate in a Title IV loan program under section 435(a) (2) of the HEA (three consecutive years of high default rates) may not receive funding under the Pell Grant program for the 1996-97 award year. Because the provision appears in appropriations legislation, it applies to only one year.

Suggested Legislative Change

Section 481 of the HEA should include a provision that schools that lose eligibility for Title IV loan programs pursuant to section 435 (a) (2) (high default rates) will also lose eligibility for the Pell Grant program for the same period.

Why Current Law Should Be Changed

Department data reflect that 48 schools lost eligibility for the Pell Grant program during the 1996-97 award year due to high default rates for loans. The estimated savings to the Pell Grant program was about $4.6 million for the 48 schools for the one year.

The statutory default initiative has proven to be an effective and efficient mechanism for eliminating from the loan programs schools whose students default at a high rate. An underlying rationale for the default initiative is that schools with high default rates are not successful in placing their students in jobs, at all, or in jobs that pay a sufficient salary or wage to allow their students to pay off the loans they have incurred to get training for those jobs. In addition, under Department regulations, schools with three consecutive years of cohort default rates in excess of 25 percent are considered to lack administrative capability to participate in all the SFA programs.

The Pell funding cut off would affect primarily proprietary schools, and as of January 1997, the Department had removed 203 proprietary schools from participation in the loan programs because of high default rates. Most of the schools were short-term vocational trade schools offering less than-two-year programs. Department data also reflect that despite the default initiative, proprietary schools still have the highest default rates: 21 percent for all proprietary schools and 23 percent for proprietary schools with less-than-two-year programs versus 6.8 percent for public, four-year programs and 6.3 percent for private, four-year programs. OIG has found that fraud, waste, and abuse is most prevalent at such schools.

Several major OIG criminal cases demonstrate the risk of loss where schools removed from the loan programs remained eligible for Pell Grants and drove up their Pell Grant receipts by using fraudulent or abusive practices. For example, at a vocational school in California the owners and financial aid director engaged in a scheme to retain Pell Grant monies for no-show students after losing their eligibility for loans. OIG's investigation resulted in an indictment for one of the owners and the financial aid director. The owners and officers are alleged to have defrauded the government of over $1 million for the period covered by the indictment. Another OIG investigation in Chicago resulted in an indictment of owners of a beauty school chain which, after being restricted in its use of loans and ultimately being removed from participating in the loan program for high default rates, substantially increased its Pell receipts by aggressive recruitment of unlikely cosmetology students, by substantially and arbitrarily increasing the up-front equipment charge, and drawing down and retaining Pell Grants for no-show students. For the two-year period covered by the indictment, it is alleged that school owners defrauded the government of at least $1.3 million.

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Restrict Distance Learning to Academic Degree Programs

Institutions that propose to offer "distance learning" courses would not be eligible for SFA program funds under current legal restrictions if correspondence and/or telecommunications courses made up more than 50 percent of the courses at the institution. These restrictions were a direct response to the costly fraud, waste and abuse that resulted from the participation in the SFA programs of a number of correspondence vocational training programs prior to 1992. If Congress were persuaded that these limitations unduly restrict the development of distance learning programs, OIG recommends that any amendment of current law be limited to institutions that provide two- or four-year programs leading to a recognized associate, bachelor or graduate degree.

Current Law Provides

There are no provisions in the current law that specifically address "distance learning." However, the HEA limits the eligibility of institutions that offer courses by correspondence and telecommunications. Based upon our understanding of "distance learning" proposals, such courses would be subject to the current statutory restrictions for telecommunications and correspondence courses (see definition of "telecommunications," HEA section 484(l)(4)).[1] Section 484(l) provides that institutions offering associate, bachelor or graduate degree programs may be eligible for the SFA programs

> **"unless the total amount of telecommunications and correspondence courses at such institution equals or exceeds 50 percent of such courses."**

Section 481(a) (3) (A) and (B) limits the participation in SFA programs of schools offering correspondence courses. Such schools are not eligible if over 50 percent of their courses are correspondence courses or if over 50 percent of their students are enrolled in correspondence courses. However, the law also provides that for two- and four-year, degree-granting institutions, the Secretary may waive the 50 percent limitation on correspondence courses "for good cause."

1 Information on the Internet about distance learning from the "Distance Education and Training Council" indicates that there is no difference between distance learning and correspondence/telecommunications study.

Considerations For Legislative Changes

If Congress believes that the law should be less restrictive in order to encourage "distance learning" using Internet, interactive and other "virtual" technology, OIG's position is that the statutory change should be limited to distance learning programs that provide two- or four-year programs that lead to a recognized associate, bachelor or graduate degree. To avoid the return of the abuses of the past and mitigate the special difficulties the Department encountered in regulating such schools, correspondence and telecommunications programs of vocational training should remain subject to current statutory restrictions.

Why Current Law Changes Should Be Limited

A number of OIG significant administrative, civil and/or criminal cases were based upon the failure of vocational correspondence programs to meet course length requirements and to pay refunds, which were areas that were especially difficult for the Department to regulate for correspondence schools. For example, a False Claims Act suit against owners of a correspondence truck driving and secretarial school in Delaware, that received over $40 million in grants over a four-year period and $234 million in loan proceeds over a five-year period, alleging fraudulent misrepresentation of course length and failure to pay at least $6 million in refunds, resulted in a significant settlement. The owners and certain school officials also pled guilty to a variety of criminal charges in connection with the fraud at the school.

The government recovered relatively little, however, in a settlement of another civil fraud suit alleging misrepresentation of course length against a correspondence truck driving/heavy equipment operation school (in Indiana) that received over $63 million in one year from the SFA programs. A Texas correspondence truck driving school, which over a two-year period received about $21 million in SFA program funds, failed to pay over $2.6 million in refunds. The owner and several employees were indicted on mail fraud, false statements, money laundering and other criminal charges. The owner's assets were ultimately forfeited as a result of a plea agreement.

In a number of OIG audits of correspondence truck driving, secretarial, and other vocational schools, we found that such schools were inflating the length of their courses. Based on the actual course length, these institutions should not have received SFA

funding for the correspondence courses. For example, in an audit of a travel agent and secretarial school in Florida, we recommended a refund of $50 million.

In 1992 GAO issued a report titled *Stafford Student Loan Program - Correspondence Schools' Loan Volume Declines Sharply*. GAO found that the borrower default rates for students attending correspondence schools were more than double the rate, 42.2 percent versus 18.3 percent, of all schools participating in the Stafford program during fiscal years 1987-89.

The fall out from the participation of vocational correspondence schools still presents significant regulatory challenges. For example, the Department has had difficulty in enforcing the "closed school" discharge under section 437 of the HEA for nine vocational correspondence schools which were unable to provide accurate attendance data. Five of these nine correspondence schools had been audited or investigated by the OIG, and significant violations of law or regulation were found.

The Distance Education and Training Council (DETC), formerly the National Home Study Council, (the accrediting agency for the vocational correspondence schools), is now the accrediting agency for distance learning schools.

References

1. Facts about the DETC.

2. OIG audit report *Audit of the Title IV Student Financial Assistance Programs Administered by County Schools, INC. Bridgeport, Connecticut*, ACN 01-00001, dated April 1991.

3. OIG audit report *Andover Tractor Trailer School, Inc., Methuen - Administration of the Title IV Student Financial Assistance Programs*, ACN 01-90003, dated December 1990.

4. OIG audit report *Report on Review of Administration of Federal Student Financial Assistance Programs at National Training, Inc. Orange Park, Florida*, ACN 04-00006, dated February 1992.

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Require Schools to Post a Surety When Appealing Loss of Eligibility Due to High Default Rates

Schools should be required to post a surety as a condition to appealing the loss of their eligibility to participate in the Federal Family Education Loan Program (FFELP) based on their excessive cohort default rates. Such a requirement will provide a needed level of protection to taxpayers who, if the school loses its appeal, suffer the unnecessary loss of millions of dollars in additional defaults and incur loan discharge costs when schools close.

Current Law Provides

Currently, a school appealing revocation of its eligibility to participate in FFELP, based on its high default rates, continues to receive additional loans and is not required to post a surety during the appeal process. Section 435 (2) (A) of the HEA, states:

> **"An institution whose cohort default rate is equal to or greater than the threshold percentage specified in subparagraph (B) for each of the three most recent fiscal years for which data are available shall not be eligible to participate in a program under this part for the fiscal year for which the determination is made and for the two succeeding fiscal years, unless, within 30 days of receiving notification from the Secretary of the loss of eligibility under this paragraph, the institution appeals the loss of its eligibility to the Secretary.... During such appeal, the Secretary may permit the institution to continue to participate in a program under this part."**

Section 437 (c) (1) of the HEA provides for the discharge of loans due to school closure as follows:

> **"If a borrower who received, on or after January 1, 1986, a loan made, insured, or guaranteed under this part and the student borrower, or the student on whose behalf a parent borrowed, is unable to complete the program in which a student is enrolled due to the closure of the institution ... then the Secretary shall discharge the borrower's liability on the loan (including interest and collection fees) by repaying the amount owed on the loan ..."**

Suggested Legislative Change

Our proposal would require a school to post a surety during the process of appealing the loss of its eligibility to participate in

FFELP based on the school's default rate. Section 435 (2) (A) of the HEA should be amended as follows:

> **During such appeal, the Secretary may permit the institution to continue to participate in a program under this part, provided the institution posts surety based on its annual loan volume and cohort default rate to protect the Secretary against loss from defaults and discharges of loans pursuant to section 437(c) of this title.**

Why Current Law Should Be Changed

When a school appeals the Department's notice to rescind its FFELP eligibility based on high default rates, the school is allowed to continue to participate in FFELP until the appeal is decided. In our opinion, the loans approved for students attending the school during the appeal process would likely default at the same rate as loans approved prior to the Department's notice. This will likely result in additional default claims for loans after the school has already been identified as having an excessively high default rate. In addition, if a school loses its appeal and is removed from the FFELP, there is a high probability that the school will close. This may result in substantial costs to the Department since all students in attendance at the school within 90 days of the date of closure will have their loans discharged (unless teach-out arrangements are made).

Department officials informed us that, as of March 5, 1997, there were 141 schools that had appeals decided in favor of the Department (based on the 1993 default rates, which were made available February 15, 1996). We were only able to find loan amount data for 104 of the 141 schools; for the remaining 37 schools, there were no loans on the National Student Loan Data System guaranteed after February 15, 1996. During the period that the appeals were being decided, $61 million in loans were guaranteed for students attending these 104 schools. Based on the 1993 default rates for these schools, a total of $22 million may be expected to be paid in default claims for these loans. Congress could mitigate this potential loss and protect the taxpayers by requiring schools that appeal their cohort default rates to post a surety.

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Legislate Separate Statutory Requirements for Vocational Trade Schools

In order to ensure that federal taxpayer money is financing only quality vocational training and that federal regulation of the SFA loan and grant programs is properly targeted, Congress should adopt separate statutory requirements, as appropriate, for non-public, vocational trade schools, and provide explicit authority for the Department to regulate such schools separately. These separate requirements should cover all institutions that are eligible for the SFA programs because they provide "programs of training to prepare students for gainful employment in a recognized occupation," that is, "proprietary institutions of higher education" and "postsecondary vocational institutions" (HEA §481, 20 U.S.C. §1088), except to the extent such schools are public institutions like community colleges.

In particular, Congress should include as statutory requirements for vocational trade schools quantitative performance standards for graduation and job placement that reasonably ensure that these schools are, in fact, preparing students for jobs in occupations for which they purport to train them.[2]

Current Law Provides

In defining the institutions that may participate in the SFA programs, the HEA appropriately draws a distinction between the two broad categories of schools:

- those institutions that provide a program of training to prepare students for gainful employment in a recognized occupation, i.e., **"proprietary institutions of higher education"** and **"postsecondary vocational institutions"** (HEA, §481, 20 U.S.C. §1088), and

- those institutions that provide educational programs that lead to a bachelor's degree or provide not less than a two-year program which is acceptable for full credit toward such a degree, i.e., **"institutions of higher education"** (HEA, §120l(a), 20 U.S.C. §1145b).

Despite this fundamental statutory distinction, for the most part, the HEA treats vocational trade schools in the first category above in

2 See page 1 for the OIG proposal that addresses performance standards in greater detail.

the same manner as academic, degree-granting institutions and mandates the same standards and procedures for these distinctly different types of educational and training institutions. Historically, this may be attributable to the fact that many vocational trade schools are proprietary schools, which were not originally eligible for the SFA programs, and were added to the definition of eligible institutions in 1972.[3] With the exposure of abuses in the vocational trade school sector starting in the late 1980's by OIG, GAO, some state agencies, and certain congressional subcommittees, Congress began to target some SFA program reform provisions to vocational trade schools. For example, the law now requires proprietary schools to certify that no more than 85 percent of their funding is derived from HEA Title IV programs. Programs under 600 clock hours in length must demonstrate that they have a 70 percent graduation rate and a 70 percent job placement rate for graduates (i.e., 49 percent of those enrolled get a job) in order to be eligible for student loans (HEA, §481(e)(2), 20 U.S.C. §1088).

However, a number of provisions added in the 1992 amendments aimed at fraud and abuse found primarily at vocational trade schools apply across-the-board to all institutions that participate in the SFA programs, e.g., requirement of accrediting agency performance standards for student achievement (§496, 20 U.S.C. §1099b); 30-day delayed disbursement of loan monies for first-time borrowers (HEA §428G, 20 U.S.C. 1078-7); and pro rata refunds for students who complete less than 60 percent of the period of enrollment for which they have been charged (§484B, 20 U.S.C. §1091b).

The Department has recognized that the HEA places burdens on all schools by adding administrative provisions that are aimed at preventing abuses in the short-term vocational schools sector. In 1995, the Department identified 22 provisions of both statute and regulations that were unnecessarily burdensome to academic institutions, but it was unsuccessful in targeting reforms to the problematic trade-school sector.

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3 Congressional Research Service, History of Proprietary School Student Eligibility for Federal Student Aid Programs, October 25, 1989.

Suggested Legislative Change

The HEA should require that proprietary institutions of higher education and postsecondary vocational institutions meet measurable performance standards for graduation and job placement, such as the 70/70 graduation and placement standards now in the law for very short-term programs. In addition, enforcement measures such as those cited above that burden academic institutions unnecessarily should be targeted to the sector where abuse has been documented: non-public, vocational trade schools. OIG is also recommending that an annual refund certification requirement be legislated for these schools.[4] Finally, Congress should include in section 481 (20 U.S.C. §1088) of the HEA or elsewhere explicit authority for the Department to regulate non-public proprietary institutions of higher education and postsecondary vocational institutions differently than other institutions of higher education.

Why Current Law Should Be Changed

Non-public, vocational trade schools, whether proprietary or nonprofit, should be treated differently in certain respects in the HEA, because by definition they have a different mission (to provide job training) and function differently in many respects from academic institutions. Moreover, substantially all the serious fraud, waste and abuse uncovered by OIG and others in the SFA programs is attributable to vocational trade schools. The failure to make appropriate distinctions in the law between types of schools leads to fraud, waste and abuse that cannot be efficiently and effectively addressed through the administrative and regulatory process.[5]

There is compelling evidence that non-public, vocational trade schools are different from others in the SFA programs and should be

4 See page 36 for the OIG proposal that addresses refund certification in greater detail.

5 We are not recommending, at this time, including public institutions that offer vocational programs, such as community colleges, for a number of reasons: (1) there are fewer federal funds at risk because such programs are state-subsidized and consequently generally cheaper than equivalent vocational programs offered by private training programs; (2) they are subject to state oversight to a greater degree than their private counterparts, which provides an additional assurance of quality; (3) to date, we have not generally documented abuse at public vocational institutions.

treated differently.[6] One such indicator is default rates for student loans, which are much higher for such schools than others. Even with the student loan default reduction provisions, which have eliminated many extremely high-default schools from participating in the SFA programs, default rates for vocational trade schools remain much higher than for academic institutions. According to the most recent available Department statistics, for fiscal year 1994, proprietary schools offering programs of all lengths had much higher default rates than public and private two- and four-year institutions, as did private two-year institutions (many of which are postsecondary vocational institutions) --

Public 4-year: 6.8 percent
Private 4-year: 6.3 percent
Public 2-year: 13.8 percent
Private 2-year: 13.5 percent
All Proprietary: 21 percent
Proprietary 2-4 years: 18.9 percent
Proprietary less than 2 years: 23 percent.[7]

According to the Department's SFA program office, all of the 203 schools that lost eligibility for the loan programs because of high default rates for the one-year period ending January 1997 were proprietary schools. Departmental data reflect that 65 percent of the schools placed on provisional certification were proprietary schools; 54 percent of those schools were cited for high default rates. Of the schools in the SFA programs that closed between fiscal year 1986 and present, 89 percent were proprietary schools.

Since 1980, over 90 percent of OIG cases and OIG-generated indictments involved proprietary business, technical and cosmetology schools, their owners, and employees. Abuses identified by OIG at these schools included receipt and retention of

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6 The Department's and other available data are reported in a manner that distinguishes between proprietary schools and others. OIG's proposal does not distinguish between proprietary schools and non-profits. It is based upon the type of training offered (i.e., that which prepares students for gainful employment in a recognized occupation), and not the school's business structure. These data are nevertheless supportive of OIG's position, because a large part of the vocational trade school training financed through the SFA programs is offered by proprietary schools.

7 U.S. Department of Education, Report to the President on Student Loan Default Initiative, January 9, 1997.

SFA monies for ineligible and no-show students; failure to pay loan and Pell Grant refunds when students withdrew; course stretching which increased the cost of programs beyond what is necessary to obtain employment; enrollment of students who do not have a high-school credential or the ability to benefit from the course; and falsification of ability-to-benefit test scores, student attendance, and academic progress. OIG work also revealed many instances of abusive recruitment practices by these schools, including monetary inducements and false guarantees of grants and job placement.

The GAO in June 1996 congressional testimony [8] echoed OIG findings, testifying that fraud and abuse at some proprietary trade schools has been central to its program concerns. GAO expressed concern about high default rates at proprietary schools and questioned whether proprietary trade schools that overwhelmingly rely on federal student aid for revenue should be allowed to continue participating in the SFA programs and to what extent proprietary trade schools are training students for jobs that do not exist.

In a February 1997 report that was part of its High-Risk Series, GAO emphasized the need for more attention to the vocational trade school sector in order to improve the integrity of the SFA programs:

> "The programs now serve more students from low-income families and those attending proprietary schools than the more traditional students the programs were intended to serve. . . . The programs' current structure makes it difficult for the Department to protect the taxpayers' financial interests.
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> * * * *
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> Also, FFELP was originally intended to finance a traditional college education. The expansion of the program to include other education and training schools, such as proprietary (for-profit and trade) schools, has resulted in grants and loans to students to attend schools that did not always provide a high-quality education.

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8 House Subcommittee on Human Resources and Intergovernmental Relations, Committee on Government Reform and Oversight.

> Abusive practices at some proprietary schools, along with plentiful loans, have contributed to loan defaults and program costs. . . . Some proprietary school operators have enriched themselves at the expense of economically disadvantaged students, while providing little or no education in return. Faced with large debts and no new marketable skills, these students have often defaulted on their loans. . . . With increased risk to the government from increasing participation in the FDLP, attention to educational quality is much more important now and in the future."[9]

The inefficiency and waste that result from failure to distinguish in the law between vocational trade schools and other institutions for purposes of the SFA programs is illustrated by the controversy over measurement of course length for purposes of institutional eligibility and calculation of grant and loan award amounts. OIG audits demonstrated that many vocational trade school programs became eligible for the grant and/or loan programs and/or increased their SFA program proceeds by converting their course length measurement from clock-hours to credit-hours without substantially changing their course content. These vocational trade schools, many of which originally offered programs six months or less in length, inappropriately adopted a longer credit-hour course length measure from two- and four-year academic institutions that is based on the premise that significant out-of-class work is required to complete the academic program.

It took four years for the Department to promulgate in final form a controversial set of conversion regulations to stop this costly abuse. Separate statutory and regulatory requirements will better enable the Department to maintain better controls over fraud, waste, and abuse in the SFA programs without an undue burden on academic institutions.

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9 GAO/HR 97-11, High-Risk Series, Student Financial Aid, pp. 22-25 (February 1997).

Eliminate the 25-Year-Old Requirement For Pell Advance Funding

Twenty-five years ago, the Pell Grant program totaled $47 million, and since the payment system was paper driven, advance funding was necessary to process payments to institutions within a reasonable time. Today, with a $6 billion dollar Pell Grant program, payments can be processed and electronically transferred to school accounts within 48 hours which eliminates the need for advance funding. Further, trying to keep up with approximately 900,000 manual adjustments totaling about $840 million (about 18 percent of total program cost) not only results in inaccurate Departmental records and increased administrative burden on schools, but also opens the Pell Grant program up to fraud, waste, and abuse by unscrupulous school owners.

Current Law Provides

The HEA under section 401 (a)(1) enacted in 1972, provides that:

> **" ... Not less than 85 percent of such sums shall be advanced to eligible institutions prior to the start of each payment period and shall be based upon an amount requested by the institution as needed to pay eligible students..."**

Suggested Legislative Change

Rescind the 1972 provision of the HEA, section 401 (a)(1), requiring advance funding of Pell. Amend section 401 of the HEA to state:

(1) the first disbursement of a student's Pell Grant is to be made available to a school only after a student starts classes in an educational program and (2) the second disbursement is to be made available only after satisfactory completion of the first half of the academic year's educational program and enrollment in the second half of the academic year program.

Why Current Law Should Be Changed

The technological advances made over the last 25 years in money and banking make reliance on an advance funding system obsolete. Currently, payments to schools can be processed in 48 to 72 hours. Such a delay should not have an impact on the operation of any school. Without elimination of the current advance funding requirement, adjustments and risk of fraud, waste, and abuse, will continue to plague the Pell Grant payment system.

Regarding adjustments, we visited a 4-year public university that processed the most adjustments for the 1994/95 Pell award year. That university processed 36,100 adjustments for $36 million. While adjustments were processed for various reasons, 6,500 adjustments for $8.5 million, were for students that never attended class. The other adjustments were to correct potential overpayments or for students that did not enroll in the second payment period. Conversely, we visited three schools that submitted few adjustments. These schools did not process any payment records until students started classes. As a result, these schools avoided the need for numerous adjustments and did not have any reconciliation difficulties.

Since the student's Pell award is for the entire academic year, the Department must be able to track and deobligate funds for students that never attend school and students that drop out prior to the second payment period. For 1994/1995, over 900,000 adjustments were processed and still about 2,000 schools were unable to reconcile their Pell Grant authorizations with actual student disbursements.

Advance funding creates thousands of unnecessary adjustments which has an impact on the Department's ability to control the Pell Grant program. Additionally, advance funding makes the program more susceptible to fraud, waste and abuse. For example, a Department program review disclosed that a school in Georgia drew down and retained over $139,000 in Pell Grant funds for students that never enrolled. A compliance audit disclosed that the school drew down an additional $464,100 for students that never attended the second half of the program. The school's Financial Aid Administrator (FAA) admitted to inappropriately drawing down Pell Grant funds, and the school agreed to process the required adjustments and return the Pell funds to the Department. However, this did not occur. Instead, the school closed and did not return the funds.

OIG investigations have identified many institutions that have abused the Pell Grant program's advanced funding system. These institutions typically target students who have the most financial need and the least motivation to complete the programs. Such schools draw down the maximum amount of advance funds allowed for students who never attend or drop out early. In addition, when

the students cancel enrollment or fail to appear, these institutions fail to refund the excess Pell Grant funds to the Department.

Requiring that a student actually starts class before Pell funds can be drawn down would lessen this type of fraud. For example, one such school carried phantom students on its books, took the maximum first and second Pell payments for the phantom students and even showed the phantom students as having graduated. Over the six years it operated in this manner, the school received over $57 million in Pell Grant funds. In a similar case, the owner of a cosmetology school recruited students by traveling around neighboring towns in a van equipped with all the necessary forms to enroll students and apply for financial aid. Most of the students never attended class. The owner never paid refunds and fraudulently obtained, on behalf of these no-show students, about $1.2 million in student financial aid funds, the majority of which were Pell Grant program funds.

Eliminating the Pell advance funding requirement will give the Department more control over the Pell Grant program, help relieve schools' reconciliation problems, and help reduce fraud, waste, and abuse.

References

1. OIG audit report *Inconsistent Institutional Pell Grant Reporting Results in Significant Expenditure Discrepancies*, ACN 11-30001, dated September 1994.

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Student Eligibility

Require Verification of Applicants' Income Data with IRS

Congress should authorize the Department to verify reported income data for student financial aid applicants and, as appropriate, their parents with the Internal Revenue Service (IRS) income data. Verification could prevent at least $100 million annually in Pell Grant overpayments to students who fail to report accurate income data on their financial aid applications. It would also relieve the burden on schools which have to verify income for selected students, and on students and parents who must provide the schools support for the income they reported on financial aid applications. It would also enhance the Department's capabilities of detecting fraud.

Current Law Provides

Under sections 401(d) and 483 of the HEA, students and parents provide financial and other data on a common financial aid application. This information is used in the needs analysis system established by Part F of the HEA to determine each applicant's eligibility and need for student financial aid. Under needs analysis, a family's prior year income and other data reported on the application are assessed to determine the expected family contribution. The HEA also requires that institutions verify eligibility information for at least 30 percent of their federal student aid applicants. To verify income, the institutions require applicants to provide copies of their, and as appropriate, their parents' federal tax returns.

Suggested Legislative Change

The following provision should be added to section 484 of the HEA:

> **(q) The Secretary of Education is authorized to confirm with the IRS the adjusted gross income, filing status, exemptions and mailing addresses reported by SFA applicants on their federal income tax returns for the purpose of verifying the income students and parents report on student financial aid applications.**

Further, to enable the Department to obtain from the IRS complete income data for applicants who are dependent, the following provision should be added to section 401(d) of the HEA:

...(3) Each dependent student desiring a basic grant shall provide the social security number of the student's parent(s) on the application form.

Why Current Law Should Be Changed

Verification of income data from the IRS would help prevent ineligible students with high personal and family incomes from receiving financial aid. It would also result in more accurate financial aid awards to students. In addition, verification with IRS would make the process less burdensome for students, parents, and schools than under the current verification process.

We performed a match with IRS for 2.3 million of the 3.7 million total Pell Grant recipients for award year 1995-96 and found that about 4.4 percent of the recipients did not report or under reported their income. As a result, for that year alone, 102,000 students received over $100 million of Pell Grants to which they were not entitled. These students may have improperly obtained subsidized loans as well.

Over 300 of the Pell Grant recipients we reviewed had under reported their income to the Department by more than $100,000. One student reported no income on the student aid application but IRS records indicated that the individual reported over $1.3 million in adjusted gross income on a federal income tax return.

Although the Department requires schools to verify income reported by selected students through a review of tax returns and other documents provided, the process cannot detect students who intentionally under report their income and/or provide false documentation. Schools verified the income of over 22,000 of the 102,000 students and concluded that the income reported on the application was accurate or within specified tolerances in virtually every case.

OIG investigations have identified many instances where a match of the reported family income with that reported to the IRS before approval of the student financial aid application would have stopped fraudulent activities. Random verification of financial status by schools is easily circumvented. For example, in one case, two individuals set up a business for the sole purpose of falsifying students' and parents' financial information on student aid

applications to make it appear that the students' families had incomes low enough to qualify for student financial aid. When necessary, they even created false tax returns that were filed with the application at the school. The students paid about $350 for the services. After 19 months of business, about 790 students at over 72 different universities had used the service. A sampling of 101 of those student files revealed that all 101 had family incomes that were too high to qualify for financial aid. At least $1.4 million in student financial aid was fraudulently obtained.

Running a similar scheme, the Assistant Director of Academic Support in the Athletic Department of the University of Miami (UM), along with 91 UM students, defrauded the Department of over $220,000 in Pell Grant program funds. Over a period of two years, he assisted student athletes, including full-scholarship football, basketball and baseball players, in submitting Pell Grant applications containing falsified information regarding the students' and their families' financial condition. If verification of the financial information was requested, the Assistant Director and/or the student, using a blank United States tax form for the relevant year, would forge the tax form to match the falsified parental information, forge the parent's signature and submit the information to UM for processing. When the student received the Pell Grant check, he would pay the Assistant Director a fee ranging from $80 to $100 and use the rest of the $1,500 for food, social events, trips, electronic equipment and other non school related entertainment.

In a case involving PLUS loan fraud, the purported student filed fraudulent applications for PLUS loans using the name and social security number of his deceased father. He eventually received over $70,000 in PLUS loan checks.

Reference

1. OIG audit report *Accuracy of Student Aid Awards Can Be Improved by Obtaining Income Data from the Internal Revenue Service*, ACN 11-50001, dated January 1997.

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Limit Professional Judgment by Financial Aid Administrators

The HEA should be amended to more specifically define the "special circumstances" necessary for the exercise of professional judgment, in order to ensure more consistency from school to school and avoid abuse that now results in Pell Grants going to students from high-income families.

Current Law Provides

Part F of the HEA establishes the needs analysis system that must be used to determine eligibility and need for student financial aid. Section 478 of Part F restricts the Department from regulating needs analysis, which includes professional judgment.

The statutory needs analysis system recognizes that part of a family's resources must be devoted to taxes, basic living costs, and other unavoidable expenses and provides allowances for such expenses. Section 479A of Part F allows Financial Aid Administrators (FAA) to use discretion or professional judgment to change these allowances where students can demonstrate special circumstances. The HEA defines the term as follows:

> **"Special circumstances shall be conditions that differentiate an individual student from a class of students rather than conditions that exist across a class of students."**

FAAs can use professional judgment to increase or decrease income and other data reported by the student, change the student's status from dependent to independent, or adjust the student's cost of attendance. The HEA requires these actions to be on a case-by-case basis and be documented. However, the HEA does not allow the Department to regulate the use of professional judgment.

Suggested Legislative Change

Amend section 479A of the HEA to clearly prohibit FAAs from using professional judgment to adjust data elements in the Expected Family Contribution (EFC) calculation for redundant or nonessential expenses claimed by students and parents. Also, amend section 478 of the Act to give the Department authority to regulate FAAs' use of professional judgment.

Specifically, the following language should be added to section 479A:

> **Any adjustments for additional expenses allowed because of special circumstances should be limited to instances where the student demonstrates the expenses were essential expenses of the student or parent that were incurred out of necessity. Such expenses shall not include any expenses that have already been provided under the standard allowances established under this part or any expenses that result in the preferential treatment of a whole class of students.**

Section 478(a) of the HEA should also be amended to give the Secretary the authority to regulate professional judgment by adding the following:

> **...(C) in regard to section 479A of this part concerning discretion of student financial aid administrators.**

Why Current Law Should Be Changed

The lack of specific provisions in the HEA to define clearly the circumstances under which professional judgment can be used and the prohibition against the Department regulating its use have contributed to abuse in the use of professional judgment. In addition, inequities exist in students' eligibility for financial aid among schools resulting in students from families with income as high as $100,000 obtaining Pell Grants.

Nationally, professional judgment is used for about 4.4 percent of Pell recipients and accounts for an estimated $155 million in additional Pell awards annually. We visited 19 schools, including five that used professional judgment frequently, and found that professional judgment actions were unreasonable or inadequately documented for about 54 percent of the Pell recipients at the 19 schools, resulting in over 800 students receiving an estimated $775,000 of Pell Grants that they would not have otherwise received. The unreasonable use of professional judgment occurred because FAAs: a) deducted from family incomes expenses that were nonessential or that were incurred by whole classes of students, b) made allowances for living and other expenses even though those allowances had already been considered in the needs

analysis system, and c) did not always adequately document their actions.

One FAA at a four-year institution summed up the current state of affairs when he stated that anyone could get federal financial aid through the use of professional judgment and that the provisions in the HEA prevented anyone from questioning those professional judgment decisions. This university used professional judgment for about half of its Pell recipients, making some students from families with annual incomes in excess of $100,000 eligible for Pell Grants. The FAA deducted from family incomes unusually high living expenses without considering whether the expenses were incurred by the families out of necessity or choice. For example, the deductions included expenses for vacations, investments, lawn care, and other nonessential items.

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Loan Programs

Require Annual Reconciliation of NSLDS Data

To save millions of dollars and enhance the Department's ability to monitor the FFELP, the HEA should be amended to require periodic reconciliation of data in the National Student Loan Data System (NSLDS) with data provided by lenders and guaranty agencies.

Current Law Provides

Section 428(c)(2)(B) gives the Secretary general authority to include provisions in guaranty agency reinsurance agreements for making reports, keeping records, and allowing access to verify records for information the Secretary may reasonably require to carry out the program.

Section 432(c)(1) and (2) give the Secretary authority to designate the categories of data to be collected.

Suggested Legislative Change

Amend HEA to add to section 485B:

(h) INTEGRITY OF DATA.

The Secretary shall establish procedures to ensure the completeness and accuracy of the data in the NSLDS. At the minimum, these procedures will require at least annual reconciliations of data maintained by NSLDS with guaranty agencies' data and with lenders' data.

Why Current Law Should Be Changed

While the current law provides the Secretary general authority related to guaranty agency reporting and record verification, the Department has not taken sufficient action to ensure that NSLDS is complete and accurate. Recent audit work and a study prepared for the Department indicate that there are errors in NSLDS data and mismatches between NSLDS data and the source data maintained by guaranty agencies and lenders.

The draft report on the NSLDS Verification Study prepared for the Department by Westat, Inc., reported significant data mismatches between data sampled from the NSLDS and confirmed with guaranty agencies and lenders. Past audit work reported that records

at a guaranty agency significantly overstated loans in repayment. In 1993, we reported that the California Student Aid Commission overstated loans in repayment as of September 30, 1991 by $1.5 billion, resulting in $16.4 million in overpaid reinsurance claims. In addition, Price Waterhouse, LLP (PW) disclaimed an opinion on the Department's 1995 financial statements primarily because data provided by guaranty agencies which was used to estimate the FFELP aggregate liability for loan guarantees of $12.9 billion, was unreliable.

NSLDS data integrity is important because the NSLDS is the Department's only source for loan level FFELP data. The Department plans to use the loan level data in the NSLDS to assess the reasonableness of the summary data submitted by guaranty agencies and lenders. The Department uses NSLDS for new aid application screening, cohort default rate computations, and Student Status Confirmation Report processing. In addition, the Department also intends to use the NSLDS as a source of data to manage the FFELP.

Guaranty agencies are the Department's primary source for loan amount and loan status information in the NSLDS. However, the agencies obtain much of the data from lenders. Westat found significant differences in data reported by guaranty agencies and lenders. Both the processes guarantors use to gather data from lenders and the processes guaranty agencies use to report data to NSLDS appear to be causing the inconsistencies.

The HEA should be amended to require reconciliations of NSLDS data to guaranty agency records and reconciliations of guaranty agency data to lender records at least annually. These reconciliations are a vital control necessary to ensure the integrity of FFELP data. Prior OIG audit work, the Westat study, and the PW financial statement audit provide sufficient evidence to conclude there are inaccuracies in NSLDS' and guaranty agencies' data, but they do not identify the cause of the errors.

To accomplish the reconciliations, the Department could require the guaranty agencies' auditors to reconcile a statistically valid sample of guaranty agency data with lender records and the NSLDS as part of the guaranty agency audit requirement. Agencies which exceed acceptable error rates should be required to reconcile all loans with

significant lenders and the NSLDS. Using a sample to assess the error rate will provide the agencies and lenders an incentive to ensure data is reported accurately. The sample results will also enable the Department to assess the reliability of the NSLDS data.

References

1. Westat, Inc., draft report *National Student Loan Data System (NSLDS) Verification Study*, dated November 1996.

2. OIG SFA Action Memorandum No. 96-05 *National Student Loan Data System (NSLDS)*.

3. Final reports of the independent accountants on the Department's annual financial statements for the year ended September 30, 1995, ACN 17-40303, dated August 16, 1996.

4. OIG audit report *Report on the Transitional Guaranty Agency's Role in Guaranty Agency Transition Strategy*, ACN 05-40007, dated June 1995.

5. OIG audit report *The Department Should Continue Its Efforts to Improve the Accuracy of Its Student Loan Database*, ACN 09-38058, dated June 1996.

6. OIG audit report *The Commission's Loans in Repayment Were Overstated by $1.5 Billion*, ACN 09-10005, dated September 1993.

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Change the Definition of Loans in Repayment

Changing the definition of loans in repayment would enhance the Department's ability to monitor and manage the FFELP. It may also have a significant impact on the amount of the Department's reinsurance payments to the guaranty agencies, which totaled $2.4 billion in fiscal year 1995.

Current Law Provides

In section 428(c)(1)(C) of the HEA, loans in repayment is defined as

> **"the original principal amount of loans made by a lender which are insured by the guaranty agency reduced by- (i) the amount the insurer has been required to pay to discharge its insurance obligations under this part; (ii) the original principal amount of loans insured by it which have been fully repaid; and (iii) the original principal amount insured on those loans for which payment of the first installment of principal has not become due pursuant to subsection (b)(1)(E) of this section or such first installment need not be paid pursuant to subsection (b)(1)(M)."**

Suggested Legislative Change

The definition of loans in repayment should be clarified and simplified to reflect the original principal amount of loans reduced by the amount of loans canceled, for which guarantees are valid and payments are due. The calculation, therefore, would be based on the actual loans in repayment as shown on the guaranty agency database.

Why Current Law Should Be Changed

The loans in repayment amount is important because it is used to monitor and manage the FFELP and to establish a "trigger figure" which determines the percent of reinsurance the Secretary will pay to the guaranty agency for default claims. The definition in the current law is overly complex, relies on historical data accumulated since the guaranty agency's initial participation in the FFELP, and uses an "exclusion style" definition which produces an unreliable amount.

The effect of the current formula is to encourage guaranty agencies to maintain a large loans in repayment figure in order to be paid 98 percent of the default claim, the maximum reinsurance rate. A smaller, accurate loans in repayment figure may reduce a guaranty

agency's reinsurance rate. For example, if the total of default claims paid by the Secretary in the current year reaches 5 percent of the amount of loans in repayment at the end of the preceding fiscal year, reinsurance to the guaranty agency will be paid at 88 percent rather than at 98 percent. The amount paid for reinsurance is further reduced to 78 percent as the amount of total default claims paid increases to 9 percent of total loans in repayment. This clearly illustrates the importance of the accuracy of the loans in repayment amount.

When the formula is applied to inaccurate data, the results may be costly to the taxpayer. For example, our 1993 audit of the California guaranty agency disclosed that the loans in repayment figure used to determine payments on reinsurance claims was overstated by $1.5 billion. As a result, the Department overpaid the agency about $16.4 million on its reinsurance claims.

Note: To clarify that the federal government is the sole, final insurer of guaranteed student loans, the President in his budget is proposing to pay 100 percent of all default claims through direct federal payments. If this proposal is accepted, the issue of loans in repayment could be resolved.

References

1. OIG Management Improvement Report 92-13, *ED Needs to Change the Legislative Definition of Loans in Repayment*, dated September 4, 1992.

2. OIG audit report *The Commission's Loans in Repayment Were Overstated by $1.5 Billion*, ACN 09-10005, dated September 1993.

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Standardize Accounting and Reporting for Guaranty Agency Reserve Funds

Guaranty agencies participating in the FFELP should account for and report program reserve funds in accordance with the same accounting principles and standards used by the Department, including use of the "accrual basis of accounting." Such a change is needed to ensure that all the Department's assets are accounted for and reported in a consistent manner and in accordance with federal accounting standards. Since guaranty agencies are either nonprofit entities or state agencies, they are subject to different accounting standards, thus making the comparison of one guarantee agency's financial information to another difficult.

Current Law Provides

The current HEA does not have any language mandating accounting standards for guaranty agencies. The HEA, in section 422 (g)(1), clearly indicates that the reserve funds of the guaranty agencies is the property of the United States

Suggested Legislative Change

We propose that the following language be added to section 422 (g)(1) of the HEA:

> **Guaranty agencies shall use a separate self balancing set of accounts to account for and report FFELP activities in accordance with federal accounting standards. These records should clearly identify federal reserve funds available for program expenses, assets purchased with program funds and outstanding program liabilities to determine and report the Department's net equity in guaranty agency reserve funds.**

Why Current Law Should Be Changed

As pointed out by Price Waterhouse, the independent auditor that performed the fiscal year 1995 Department-wide financial statement audit, the Department is responsible for establishing sufficient controls to properly monitor guaranty agency operations and account for transactions executed and assets held on its behalf. Under the FFELP, guaranty agencies are crucial intermediaries in delivering guaranteed loans to students whose financial and credit management activities closely interact with those of the Department. More specifically, from a financial point of view, guaranty agencies act as transfer agents for the Department to pay for the expenses of the FFELP.

By law, the reserve funds held by guaranty agencies to pay FFELP expenses are the property of the federal government. Therefore, guaranty agency reserve funds represent an asset to the Department. The Department is responsible for accounting for and reporting this asset to the taxpayers in its financial statements in accordance with the applicable principles and standards effective at the time of their preparation.

Currently, guaranty agencies only provide the Department with data about the actual receipt and delivery of program funds during a period of time on the "cash basis of accounting." This method of accounting does not report the funds and assets available for future program expenses and the liabilities outstanding that must be satisfied with program resources.

To properly account for and report guaranty agency reserves, the Department must have specific information on:

(i) the funds available at guaranty agencies to pay program expenses;
(ii) the assets held by guaranty agencies purchased with program funds; and
(iii) the program liabilities outstanding that must be reimbursed with program funding.

This information can only be obtained using the "accrual basis of accounting" because this method provides information that matches revenues with the related expenses to reflect more accurately an entity's performance during a period of time. Without knowing this information, the Department cannot properly control and accurately report this asset in its financial statements.

References

1. Final reports of the independent accountants on the Department's annual financial statements for the year ended September 30, 1995, ACN 17-40303, August 16, 1996.

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Require Certification of Refund Liabilities by Vocational Trade Schools

Schools and/or school owners of vocational trade schools[10] should be required to report and certify their refund liabilities on at least an annual basis so that the Department can identify schools that are delinquent and the extent of their refund liabilities.[11]

Current Law Provides

Section 484B of the HEA, 20 U.S.C. §1091b, deals with institutional refunds by specifying that schools must have a "fair and equitable refund policy" and defining that term. The law contains no requirement for an accounting by schools of their refund liabilities.

Suggested Legislative Change

Language should be added to section 484B of the HEA to require an annual certification by school owners or other controlling persons of vocational trade schools concerning their institution's SFA program refund liabilities.

Why Current Law Should Be Changed

It has been the experience of OIG and it is acknowledged by the Department that failure on the part of some vocational trade schools to make required refunds of SFA program funds (both loans and grants) when students fail to enroll or withdraw is a significant abuse in the SFA programs. This abuse is very hard to fix at the back-end, because it is difficult to recoup money from school owners for their failure to pay refunds and even more difficult to identify and obtain redress for victimized students. For example, in one California case, a federal jury recently found a former trade school owner guilty of a number of crimes in connection with his failure to pay at least $4.3 million in refunds, and additional evidence concerning another school location reflected a failure to make another $2 million in refunds. OIG also found that the school owner had no unencumbered assets to attach or seize, and students,

10 This term includes "proprietary institutions of higher education" and "postsecondary vocational institutions" within the meaning of section 481 of the HEA.

11 As an additional safeguard for ensuring program integrity, Congress should also mandate that the Student Status Confirmation Reports required for the FFELP and for the FDLP for all schools include a line item for refunds due and paid. If schools have sound recordkeeping and accounting systems and make refunds appropriately, this should not be burdensome.

on whose behalf loan refunds were not made, remained liable for those loans plus interest. (Other examples of OIG cases involving failure to pay refunds are described in our referenced congressional testimony.)

Administrative back-end fixes have also proved ineffective. If a school is terminated for failure to pay refunds, it has little or no incentive to pay past liabilities. The Department is limited in its ability to collect from corporate owners. The OIG has also seen a number of instances where schools with refund liabilities were allowed to remain in the SFA programs based on a promise to repay over a long period of time and without interest. This almost invariably resulted in eventual closure of the school without the refunds being paid and additional students being victimized.

The Department does a poor job of enforcing the refund regulations against schools. A principal reason, in our view, is that it does not have a mechanism for determining systematically the amount of refunds owed by schools. As a result, the Department does not take administrative action in a timely manner when schools are behind in making refunds. Until such time as a program review or the annual audit is completed at a school or the matter comes to the Department's attention by way of complaints or through some other extraordinary circumstance, the Department does not take action to ensure that schools are making the refunds they owe in a timely manner. In many cases, by the time the Department becomes aware of a refund arrearage, the amount is so substantial that the school closes or is sold, and the refunds are never paid.

Having a clear and unambiguous certification of refund liabilities would not only enhance the Department's capacity to enforce schools' refund obligations, but it would enhance OIG's ability to make criminal cases against parties that fail to pay refunds. If a school owner or controlling person deliberately understates the school's refund liability, a clear false statement would be available as a basis for criminal prosecution. We also believe that the obligation to sign a certification on a regular basis that would subject school owners to scrutiny by the Department and possible criminal liability for misrepresentation would give some school owners, who might otherwise let refunds become delinquent, the incentive to become current in their refund payments.

OIG's data from audits and investigations reflect that the problems of unpaid refunds principally occur at vocational trade schools. In our view, these schools have much higher default rates for student loans than degree-granting institutions, which is an indicator of risk for unpaid refunds.

References

1. OIG memorandum on *Certification of Refund Liabilities*, dated January 22, 1997.

2. Testimony of the Inspector General before the Subcommittee on Labor, Health and Human Services and Education, Committee on Appropriations, United States Senate, dated May 13, 1994.

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Require Discharge of Loans to the Extent of Unpaid Refunds for Student Victims

Student victims of refund fraud should be eligible for loan discharges to the extent of the owed and unpaid refund. The Department would have recourse against the party owing the refund (typically, a school or school owner). The Department should be required to report to Congress annually the amount of such loan discharges.

Current Law Provides

In the HEA Amendments of 1992, Congress provided for loan discharges for two classes of victimized students: (1) those students unable to complete their programs, because the school closed, and (2) those students whose eligibility to borrow was falsely certified (with respect to the student's ability to benefit from the program). Students whose schools did not make appropriate refunds to lenders when the students did not actually enroll or withdrew are still legally liable for those loans.

Suggested Legislative Change

Section 437 of the HEA, 20 U.S.C. §1087, which contains the current discharge language, should be amended to add the following italicized language:

"(c) DISCHARGE. --

(1) IN GENERAL. -- If a student borrower who received, on or after January 1, 1986, a loan made, insured, or guaranteed under this part is unable to complete the program in which the borrower is enrolled due to the closure of the institution or if such student's eligibility to borrow under this part was falsely certified by the eligible institution *or if the eligible institution failed to make a refund of loan proceeds which it owed to such student's lender*, **then the Secretary shall discharge the borrower's liability on the loan (including interest and collection fees) by repaying the amount owed on the loan and shall subsequently pursue any claim available to such borrower against the institution and its affiliates and principals or settle the loan obligation pursuant to financial responsibility authority under subpart 3 of part H.** *In the case of a discharge based upon a failure to refund, the amount of the discharge shall not exceed that portion of the loan which should have been refunded.*

The Secretary of Education shall report to [particular Committees of Congress] annually as to the dollar amount of loan discharges attributable to failures to make refunds."

Why Current Law Should Be Changed

The failure by schools to pay refunds of loan proceeds when students do not actually enroll or withdraw is generally recognized to be a major problem in the SFA programs. The problem can reach such proportions that it constitutes fraud which has been prosecuted criminally in a number of OIG cases. The problem has been particularly serious in the vocational trade school sector, since recruitment practices and other factors characteristic of such schools tend to increase the amount of such schools' refund obligations.

For example, in a California case, a federal jury found a former trade school owner guilty of a number of crimes in connection with his failure to pay at least $4.3 million in refunds and additional evidence concerning another school location reflected a failure to make another $2 million in refunds.[12] Owners of a technical business school in Illinois were found guilty of crimes in connection with their failure to make at least $ 1.4 million in refunds. In both these cases, the evidence showed that the owners used the money to finance extravagant lifestyles. Another OIG investigation of a truck driving school in Delaware which failed to make over $6 million in refunds (among other fraud) and whose owners and officers altered and hid records to obstruct OIG auditors resulted in several guilty pleas and a civil settlement of about $13 million in cash and liquidated real estate of the owners. In the case of a Texas truck driving school, $2.6 million in refunds was not made, and an OIG investigation led to guilty pleas and a criminal forfeiture of the owner's assets. The sale of those assets resulted in recovery by the government of only $777,800.

Except in exceptional circumstances, students on whose behalf loan refunds were not made, remain liable for those loans plus interest. In just the cases cited above, thousands of students and persons who never enrolled as students were affected by the failure of schools to pay refunds. Not only are their credit ratings harmed, but they lose

12 The dollar figures in this paragraph include both loan and Pell Grant refunds. Pell Grants do not have to be repaid by the student, and the failure to refund them would not require a discharge. In each example cited, a substantial portion of the refunds consist of loan refunds, and the aggregate figures are used to show the extent of the documented fraud.

their eligibility for additional SFA, including grants, and for other federal benefits. In many cases, this is devastating for them, since most of the students are from disadvantaged backgrounds and of limited means. These students are just as victimized, if not more victimized, than their fellow students whose schools close or whose ability to benefit is falsely certified and who are eligible for loan discharges. Under current law this class of student victims is not treated equitably, since they must pay the full amount of their loans.

The Department has no mechanism for determining on a regular basis the amount of refunds owed by a particular school. Until such time as a review is conducted at a school or the matter comes to the Department's attention by way of complaints or through some other circumstance, the Department does not take action to ensure that schools are making the refunds they owe in a timely manner. In many cases, by the time the Department becomes aware of a refund arrearage, the amount is so substantial that the school closes and the refunds are never paid. The proposed requirement to have the Department report to Congress annually on the amount of discharges attributable to failures to pay refunds will provide an incentive on the part of the Department to better enforce the refund regulations.

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Prohibit Consolidation of Defaulted Loans

Defaulted Title IV loans should not be consolidated. The process of consolidating loans is expensive, there is a high likelihood of re-default, and the borrower, upon consolidation, is eligible for additional loans. The Department as of June 10, 1996 paid $23 million to consolidate into the William D. Ford Federal Direct Loan Program (FDLP) 29,431 defaulted loans previously held by the Department's Debt Collection Services (DCS). These consolidations resulted in the Department collecting $8.53 less per month per loan in the FDLP than what was collected by DCS.

Current Law Provides

The current HEA allows for consolidation of defaulted loans in both the FFELP and FDLP.

For FFELP the consolidation of defaulted loans is permitted in section 428(C) of the HEA. Section 428C(a)(3)(A) includes in the definition of an "eligible borrower" a borrower that is in default. Further, section 428C(a)(4)(A) includes in the definition of "eligible student loans" loans that are in default.

For FDLP the consolidation of defaulted loans is permitted in section 455(g) of the HEA. This section simply cites that eligibility is the same as section 428C(a)(4).

Suggested Legislative Change

We propose that the HEA be amended to prohibit the consolidation of defaulted loans. In order to achieve this, the stricken sections of the law as shown below need to be deleted.

HEA section 428C(a)(3)(A) states:

> **"For the purpose of this section, the term "eligible borrower" means a borrower who, at the time of application for a consolidation loan is in repayment status, or in a grace period preceding repayment~~, or is a defaulted borrower who has made arrangements to repay the obligation on the defaulted loans satisfactory to the holders of the defaulted loans.~~"**

HEA section 428C(a)(4) states

> **"For the purpose of paragraph (I), the term "eligible student loans" means loans -**
>
> > **(A) made, insured, or guaranteed under this part; ~~including loans on which the borrower has defaulted (but has made arrangements to repay the obligation on the defaulted loans satisfactory to the Secretary or guaranty agency, whichever insured the loans);~~"**

Why Current Law Should Be Changed

Consolidating defaulted loans does not significantly benefit the Department, the lenders, or the borrowers. In fact the consolidating of defaulted loans is costly.

Department

In 1995 the Department began consolidating defaulted loans held by the Department into new FDLP loans. In January 1996, the OIG's audit of this process concluded that it was not cost effective because:

- The prospect of repayment of the new FDLP loans was low and the likelihood of re-default was high given the poor payment history of the defaulted borrowers.
- There were high up-front costs, largely from collection agency and servicer fees, that we believed would not be recouped. Defaulted borrowers who consolidate into new FDLP loans and repay their new loans under the income contingent repayment (ICR) option may pay nothing or minimal payments too small to repay their loans.
- Revenues from involuntary collection methods such as tax refund offsets and wage garnishment were lost because these methods are only used for defaulted loans.
- Defaulted borrowers who consolidated became eligible for additional student loans and grants and pose a significant risk of defaulting again.

In July of 1996 the Department did an analysis of 29,431 DCS borrowers who consolidated into the FDLP between March 14, 1995 and June 10, 1996. The study corroborated our conclusion that consolidation was not cost effective. The study revealed that the Department paid on average $778 per loan to collect on average $8.53 monthly per loan less after consolidation than it was collecting previously.

Lenders

In April 1996 the Student Loan Marketing Association (Sallie Mae), the largest holder of FFELP loans, informed guarantee agencies that it would no longer accept defaulted loans for consolidation because of changes in the industry, their past experience, and their ability to obtain guarantees for defaulted loans. Further, Sallie Mae sent a letter to the Department stating that the default rate of Smart Loan accounts that contain previously defaulted loans is more than double the default rate of Smart Loan accounts that do not contain previously defaulted loans.

The lenders for each Consolidation loan pay the Department an annual fee of 1.05 percent of the principle plus accrued interest. Further, if a Consolidation loan defaults the lender gets paid only 98 percent of the loan value. Therefore, Consolidation loans with high default rates are costly to the lenders.

Borrowers

For the borrowers, the consolidation of defaulted loans is expensive in either program. The borrower pays a collection fee on the old defaulted loans as though they paid them in full.

As indicated above, to consolidate defaulted loans into FDLP it costs the Department an average of $778. However, the Department charges the borrower on average $700 of this cost as a collection fee on their defaulted loans. The borrower now has $700 of new debt to repay in addition to their previous defaulted debt. If these are marginal borrowers that did not have the income to pay their original loans, the additional debt only worsens their situation.

Defaulted borrowers in the Department's Debt Collection Service are now able to repay their loans using ICR without the expense of consolidation.

References

1. OIG audit report *Cost Analysis of the Department's Initiative to Consolidate Debt Collection Service Loans Into The Direct Loan Program*, ACN 11-50002, January 1996.

2. Sallie Mae's April 16, 1996-letter to the Department.

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Require the Determination of the Ability to Repay PLUS Loans and Require Joint Parent/Student Liability

Determining ability to repay and requiring joint parent/student liability are necessary to protect the PLUS loan program from abuse. Since the HEA Amendments of 1992 eliminated the $4,000 academic year and $20,000 aggregate limit, PLUS loans made above the former $4,000 limit have soared to $2.4 billion. Many parents close to retirement may be burdened with payments that exceed their income which could contribute to increases in defaults, and discharges due to death, disability, or bankruptcy.

Current Law Provides

The PLUS loan is addressed under section 428B (b), which states that individual loans cannot exceed the estimated cost of attendance minus other estimated financial assistance for the enrollment period. While borrowers must pass a credit check, there is no requirement to determine a borrower's ability to repay his or her loan balance and no requirement that the student cosign the parent's promissory note.

Suggested Legislative Change

Section 428B (b) should be amended to read:

> **Standard banking procedures must be used to determine the borrower's ability to repay the loan. All promissory notes for PLUS loans disbursed on or after July 1, 1998, shall be signed by the parent and student. In the event of the parent's death, disability, bankruptcy or default, responsibility for the loan balance shall be transferred to the student.**

Why Current Law Should Be Changed

In the two years since the PLUS loan limits were eliminated, the average loan grew to about $8,000; there were 17,132 individual loans in excess of $15,000. About 1,200 of those loans were in excess of $25,000.

We found that older parents are borrowing more money and will, in many cases, be in retirement prior to paying off their PLUS loans. For example, one parent took out four loans in 1993/94 for a total of $90,000. He became 61 years old in February 1997. Another parent, who borrowed $103,550 for five loans in 1993/94, was 55 years old in February 1997. For many parents, such large loan balances may exceed their ability to pay. Further, expected life

spans may be too short to liquidate loan balances in those instances where older parent borrowers are approved for 30 year repayment plans. Without amendments to the HEA, instances of death, disability, bankruptcy, or default, will require taxpayers to absorb these large loan balances. Having students, who benefitted from the educational loans, cosign the promissory notes, would provide an additional level of protection for the taxpayer.

Using standard banking procedures to determine the parent's ability to repay the loan also would help reduce the level of fraud and abuse in the PLUS loan program. OIG cases have led to indictments and convictions involving a number of PLUS fraud rings where the perpetrators, through the use of false information on PLUS loan applications, were able to fraudulently obtain anywhere from $70,000 to $1,000,000 in each case.

Typically, the fraud rings use false names, false social security numbers, false dates of birth and other falsified personal information. One ring leader actually bribed a Social Security Administration employee to obtain good social security numbers. Another individual regularly used his deceased father's name and social security number. In these cases, a credit worthiness check on the borrower would have revealed the falseness of the social security numbers, the fact that the names did not match the so-called good social security numbers and the fact that one borrower was deceased.

References

1. OIG SFA Action Memorandum *PLUS Loans to Some Parents May Exceed $200,000! Will Those Parents Be Able to Repay*, dated September 28, 1995.

2. Summary of PLUS loans over $4,000 disbursed during the period 7-1-93 - 6-30-95.

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Law Enforcement

Require That SFA Records Be Retained for Five Years and That Certain Original Records Be Retained

The statutory change in the length of the record retention requirement for Department administered programs will adversely impact the integrity of the SFA programs by making OIG investigation of program fraud much more difficult and, in some cases, make successful prosecution impossible. In addition, a regulation allowing all institutions to retain required records in electronic formats exacerbates the problem.

Current Law Provides

The Improving America's Schools Act of 1994, Pub. L. 103-382, amended Section 437 (renumbered Section 443) of the General Education Provisions Act (GEPA) to reduce from five years to three years the length of time that a recipient of funds under programs administered by the Department must maintain records. This three-year retention period is codified at 20 U.S.C. § 1232f(a), and it became effective on October 20, 1994. On November 27, 1996, the Department amended its regulations, 34 C.F.R. Part 668.24(d), to implement the amendment of GEPA and permit all institutions to maintain required records in microform, computer file, optical disk, CD-ROM or other media formats. This regulatory amendment will become effective on July 1, 1997.

Suggested Legislative Change

Modify GEPA and/or the HEA to return to a five-year record retention requirement for Title IV programs and mandate the retention of original documents for certain categories of records.

The last sentence of Section 443(a) of GEPA, 20 U.S.C. § 1232f(a), would be amended to read as follows (amended language is italicized):

> **The recipient shall maintain such records for three years after the completion of the activity for which the funds are used,** *except that eligible institutions participating in the programs authorized under Title IV of the Higher Education Act shall maintain such records for five years following the student's last day of attendance at the institution in the case of the Federal Family Education Loan Program or Federal Direct Loan Program and five years*

after the end of the award year to which the record relates in the case of all other Title IV programs. For any record that contains a signature, seal, certification or other image or mark required to validate the authenticity of its information, the record must be maintained in its original format for the duration of the required retention period.

Alternatively, the substantive amendments could be made in the HEA, with minimal change to GEPA. The GEPA provision would be amended as follows:

The recipient shall maintain such records for three years after the completion of the activity for which the funds are used, *except for institutions participating in the programs authorized under Title IV of the Higher Education Act, which shall maintain such records for the periods prescribed therein.*

The HEA, 20 USC §1094, would be amended to add a subsection (f), as follows:

(f) Record Retention

Eligible institutions participating in the in the programs authorized under this Title shall maintain all required records for five years following the student's last day of attendance at the institution in the case of the Federal Family Educational Loan Program and the Federal Direct Loan Program and five years after the end of the award year to which the record relates in the case of all other Title IV programs. For any record that contains a signature, seal, certification or other image or mark required to validate the authenticity of its information, the record must be maintained in its original format for the duration of the required retention period.

Why Current Law Should Be Changed

Most of OIG's criminal and civil fraud investigations target vocational trade schools that participate in one or more of the grant and loan programs under Title IV of the HEA. The design of the programs and the manner in which they are administered leaves most of the critical documentation justifying the receipt by the schools of federal funds in the possession and control of the schools themselves. Without these documents, most investigations would not result in successful prosecutions.

The cases of institutional program fraud investigated by the OIG may take more than three years to develop, because of the time it takes to discover the fraud coupled with the period necessary to perform the usually extensive work necessary to support a criminal or civil fraud case. In addition to analyzing the documents for proof or corroboration of the fraud itself, the documentary evidence must be analyzed to determine the loss to the government for purposes of sentencing under Federal Sentencing Guidelines in criminal fraud cases and/or for purposes of establishing damages in civil fraud cases. The OIG usually needs several years of institutional documents for these purposes. OIG investigations will be limited severely or thwarted altogether by lack of documentary evidence if schools destroy their records after three years.

Furthermore, the records relating to student loans need to be maintained by institutions for the full five-year period to ensure the Department's ability to confirm student eligibility for the loan.

The three-year record retention requirement applies to all institutions regardless of the type of institution, its track record in the programs or any history of compliance problems. An alternative approach would be to amend GEPA and/or the HEA to carve out a five-year retention period for non-degree-granting trade and technical schools (a "proprietary institution of higher education" or "postsecondary vocational institution," within the meaning of the HEA), for institutions provisionally certified, for institutions on reimbursement, or for institutions subject to administrative action within the previous five years.

The record retention regulations currently in force do require that all records be maintained for the duration of any program review, audit or investigation, and this requirement should certainly be retained. However, it is not always sufficient to protect the federal interest if

the school is unaware of the existence of an OIG investigation. In many cases, it is not in the government's interest for the schools to be made aware of a pending investigation until appropriate preliminary evidence has been collected in the case. The current three-year retention requirement could compromise an investigation, if the case had to be disclosed prematurely to preserve documents from destruction.

A related impediment to successful prosecution of program fraud is the destruction of original documents containing signatures, seals, certifications or other image or mark required to validate the authenticity of its information. Recent amendments to Department regulations permit schools to retain only imaged documents, not originals. Many OIG investigations hinge on forgery, falsification or other fraudulent alteration of documents required to establish student eligibility for financial aid. The original document containing the falsification or alteration is a critical piece of evidence to prove the fraud, particularly in a criminal case. Where there has been forgery, the original handwriting must be available to perform an acceptable handwriting analysis, which in many cases is essential to prove the forgery.

Many successful OIG investigations are based upon altered original documents in student files. For example, in one case altered aid applications and Institutional Student Information Record (ISAR), (a document which is basis for determining a student's eligibility for federal financial aid) were made by cutting, pasting and using "white-out." These altered ISIRs were photocopied so that they looked unaltered and submitted to support claims for reimbursement of Pell Grants. The student files at the schools contained the original, altered documents, which were crucial to the criminal case. Numerous OIG criminal cases are based upon evidence of falsified General Equivalency Diploma (GED), high school diplomas, tax documents and other originals of materials found in student files at schools. For example, an OIG investigation involved an altered photocopy found in a student file; investigators were able to distinguish different shades of ink to reveal the alteration, which could not have been discovered from an imaged media format reproduction.

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Apply the Extended Statute of Limitation for Financial Institution Fraud to the FDLP

The government should be able to prosecute fraud involving loans made under the FDLP to the same extent as that involving loans made under the FFELP. The Department makes the loan money available under the FDLP; however, it is not a "financial institution" within the meaning of 18 U.S.C. §20. Therefore, unlike in the FFELP, the bank fraud statute with its extended 10-year statute of limitations would not apply to fraud in the FDLP; nor would the 10-year statute of limitations apply for wire and mail fraud and racketeering affecting a financial institution.

Current Law Provides

Bank fraud, wire and mail fraud schemes, and racketeering affecting financial institutions are subject to a 10-year statute of limitations, 18 U.S.C. §3293. Schemes and artifices to defraud a financial institution may be prosecuted under the bank fraud statute, 18 U.S.C. §1344.

Federal law defines "financial institution" as an insured depository institution, credit union, or other non-governmental entity within the nine categories described in 18 U.S.C. §20. The definition does not cover a federal agency or department that acts like a bank in making money available for loans.

Suggested Legislative Change

Amend the HEA to provide that loans made pursuant to the FDLP will be treated like loans made by financial institutions for purposes of financial institution offenses under 18 U.S.C. §3293 and for purposes of bank fraud, 18 U.S.C. §1344. Language to this effect could be added to section 451 or 452 of the HEA, 20 U.S.C. §1087a, 1087b.

Why Current Law Should Be Changed

The amount of criminal fraud in the loan programs, particularly in the trade and vocational school sector, outstrips the ability of the OIG, with fewer than 100 investigators nationwide, to address all complex cases within the general five-year statute of limitations period. The cases of institutional fraud affecting the loan programs are complex and take substantial periods to investigate in a manner sufficient to result in successful prosecution, including proof of the fraud scheme, amount of the loss, and identification and seizure or other recovery of available assets to reimburse the government for its loss. Moreover, there are a number of important factors outside

the control of OIG that often prolong the period necessary to bring these complex cases to indictment, e.g., the limited resources and competing priorities of federal prosecutors.

For these reasons, it has sometimes proven necessary in cases involving the FFELP -- which uses money provided by private lenders that fall within the statutory definition of "financial institutions" -- to use the extended 10-year statute of limitations for bank fraud, wire and mail fraud, and racketeering affecting a financial institution. This would not be possible if the institution involved were in the FDLP, because the FDLP uses federal funds directly and does not use loan money from financial institutions. Schools choose whether to participate in the FFELP or the FDLP, and exactly the same criminal behavior would potentially be subject to a much longer statute of limitations if the school happened to be in the FFELP.

OIG fraud cases overwhelmingly have involved proprietary trade and vocational schools, and 41 percent of schools in the FDLP were proprietary schools as of October 1996.[13] The HEA should be amended so that fraud committed at FDLP schools will have the same consequences under the criminal law as that committed at FFELP schools.

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13 GAO 97-45, Student Loans, Selected Characteristics of Schools in Two Major Federal Loan Programs, January 1997.